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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 803

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

BASALT ROCK CO., INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Tax Court (R. 148-170), together with the dissenting opinions (R. 170-179), are reported at 10 T. C. 600. The opinion of the Court of Appeals (R. 220-224) is reported at 180 F. 2d 281.

JURISDICTION

The judgment of the Court of Appeals was entered on February 6, 1950 (R. 224). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

Taxpayers which, for income tax purposes, account for income from long-term contracts on the completed-contract method of accounting were given an election by Section 736 (b) of the Internal Revenue Code to account for such income on the percentage-of-completion method for excess profits tax purposes. Applicable Treasury Regulations provide that, when the election has been exercised, the percentage-of-completion method should be used for purposes of the excess profits tax, whether that tax is computed under Section 710 (a)(1)(A) or under Section 710 (a)(1)(B) of the Internal Revenue Code.

The question is whether the court below erred in holding that a taxpayer which exercises the election is required to compute such income on this basis for purposes of the excess profits tax imposed by Section 710 (a)(1)(A), but is not required to use this accounting method with respect to the computation under Section 710 (a) (1) (B), and in expressly holding invalid the applicable Treasury Regulations which require a contrary result.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations are set forth in the Appendix, *infra*, pp. 17-30.

STATEMENT

The Tax Court adopted the stipulated facts as its findings of fact (R. 149). Those which are material

to the issue presented here may be summarized as follows:

The taxpayer is a corporation existing under the laws of California. It is engaged in the business of shipbuilding, and manufacturing concrete aggregates, road and fuel oils, and building materials (R. 149). In the course of its business, the taxpayer has entered into certain contracts whose performance requires more than 12 months. In accordance with the provisions of applicable Treasury Regulations, the taxpayer accounted for the income from these contracts by the completed-contract method of accounting in its income and declared value excess profits tax returns. Its other income was accounted for in accordance with the accrual method of accounting. These methods are also the methods regularly employed by the taxpayer in keeping its books of account. (R. 149-150.)

On or prior to filing its excess profits tax return for 1942, the taxpayer exercised the election provided for in Section 736 (b) (*infra,* pp. 23-24) to compute its income from long-term contracts on the percentage-of-completion method. The issue in this case is whether, because of this election, the percentage-of-completion method of accounting is required in the computation of the taxpayer's surtax net income for the purposes of the excess profits tax imposed by Section 710 (a) (1) (B), it being conceded that this method of computation is required for

determining the taxpayer's adjusted excess profits net income for the purposes of the alternative excess profits tax imposed by Section 710 (a) (1) (A).[1] The parties have stipulated what are the pertinent figures involved under both methods of accounting. (R. 55-63, 76-79, 150-153.)

The Tax Court, in a decision reviewed by the full court, decided that the interpretation made by the Commissioner and set forth in his Regulations (*infra*, pp. 27-30), namely, that the election in Section 736 (b) applies to the computation of corporation surtax net income for the purposes of the tax imposed by Section 710 (a) (1) (B), is correct (R. 148-170). Judge Van Fossan wrote a dissenting opinion, in which Judges Arundell, Black, and Johnson concurred (R. 170-176). A separate dissenting opinion was written by Judge Kern; Judges Black and Arundell agreed with this dissent also (R. 176-179).

The Court of Appeals for the Ninth Circuit reversed the Tax Court. It held that the election

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[1] Section 710(a) (1) imposes a tax upon the adjusted excess-profits net income equal to the lesser of two alternative taxes specified in Section 710(a) (1) (A) and Section 710(a) (1) (B).

Under Section 710(a) (1) (A), the tax is equal to "90 per centum of the adjusted excess-profits net income."

Under Section 710(a) (1) (B), the tax is stated to be

> "an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26(e) (relating to income subject to the tax imposed by this subchapter)."

under Section 736 (b) applied only to the computation required by Section 710 (a) (1) (A), and that the Commissioner's Regulations were invalid in requiring that income from long-term contracts be accounted for on the percentage-of-completion method with respect to the computation of corporation surtax net income for the purposes of the tax imposed by Section 710 (a) (1) (B).

REASONS FOR GRANTING THE WRIT

The court below, reversing the decision of the Tax Court, has invalidated the provisions of a Treasury Regulation which otherwise would have been dispositive of the precise issue of this case. This decision presents a question of substantial importance to the revenue under the provisions of the excess profits tax law. It also raises a fundamental and equally important question concerning the deference to be accorded to the administrative interpretations of the revenue laws, as announced in Treasury Regulations which are promulgated pursuant to statutory authority. The holding below, in declaring invalid the particular provisions of the Regulation here involved, is, when measured against the statute being interpreted, in conflict with the decisions of this Court which have repeatedly declared that the courts must apply the Commissioner's Regulations except when plainly inconsistent with the statute.

1. Taxpayers who regularly keep their books and

report their income from long-term contracts on the completed-contract method of accounting were, in certain circumstances, given an option by Section 736 (b) of the Internal Revenue Code (Appendix, *infra,* pp. 23-24) to compute "income" from such contracts on the percentage-of-completion method of accounting "for the purposes of this subchapter," *i.e.,* for purposes of the excess profits tax, "in accordance with regulations prescribed by the Commissioner with the approval of the Secretary." Those who, like the taxpayer, exercised the election were, however, still required to compute such income on the completed-contract method of accounting for the purposes of the ordinary corporate income taxes imposed by Chapter 1.[2]

The excess profits tax levied by Congress during the taxable year (1942) was 90 percent of a taxpayer's "adjusted excess profits net income" or an amount which, when added to the income tax, equalled 80 per cent of "the corporation surtax net income, computed under section 15" (and computed without regard to the credit provided in Section 26 (e)), the tax being the lesser of these amounts. Section 710 (a) (1) (A) and (B), Internal Revenue Code (Appendix, *infra,* p. 20; fn., *supra,* p. 4). Section 35.736(b)-3, Treasury Regulations 112 (Appendix, *infra,* pp. 27-30), promulgated under the general authority reposing in the Commissioner

[2] These accounting methods are described in Sec. 29.42-4, Treasury Regulations 111 (Appendix, *infra,* pp. 26-27).

as well as under the specific authority granted by Section 736 (b) itself, provides that a taxpayer who exercises the election under that section should, with reference to long-term contracts, account for gross income and deductions by using the percentage-of-completion method of accounting in computing adjusted excess profits net income for the tax imposed under Section 710 (a)(1)(A). It also specifically provides that with respect to the computation under Section 710 (a)(1)(B), the corporation surtax net income computed under Section 15 should likewise be calculated by accounting for income from long-term contracts pursuant to the percentage-of-completion method of accounting which the taxpayer has elected to employ.

The court below held that the taxpayer's election under Section 736 (b) "applied to the computation required by § 710 (a) (1) (A). It did not apply to any of the computations required by § 710 (a) (1) (B)" (R. 223) which refer to "the corporation surtax net income, computed under section 15 * * *." Accordingly, the court ruled that the Commissioner's Regulations were invalid in requiring the taxpayer to use the percentage-of-completion method when accounting for income from long-term contracts in computing the amount of its corporation surtax net income for the purposes of Section 710 (a) (1) (B).

2. The Court of Appeals, unaided by any language in Section 736 (b) or the other excess profits tax provisions, struck down the Commissioner's Regulation because it concluded that the election under Section 736 (b) could be applied only to computations under Section 710 (a)(1)(A), and not to those under Section 710 (a) (1) (B). But, at the very least, it is clear that the Regulation has reasonable warrant in the statute and cannot be said to depart from its wording or plan. The election conferred by Section 736 (b) is not, by its terms, limited to computations under Section 710 (a) (1) (A), nor is it limited to the calculation of "adjusted excess profits net income," on which the tax is imposed under Section 710 (a). On the contrary, the election relates to the computation of "income" for the purposes of the "subchapter" which imposes the excess profits tax, and on its face would seem to require that whenever "income" is to be computed for excess profits tax purposes the percentage-of-completion method must be used.

And it is "income" which, under the statute, is the starting point for computing both "corporation surtax net income" [to which Section 710(a)(1)(B) refers, and the meaning of which forms the nub of the controversy here] and "adjusted excess profits net income" [referred to in Section 710 (a)(1) (A), and which must admittedly be calculated under the Section 736(b) method]. Both of these terms are defined in such a way that they have a

similar, intermediate point of reference, and they both derive from the very same point of origin; accordingly, they should receive a parallel construction. Thus, "adjusted excess profits net income" equals "excess profits net income," with certain credits and adjustments.[3] "Excess profits net income," in turn, is defined as "the normal-tax net income, as defined in section 13(a)(2), for such year," with certain adjustments.[4] This latter concept is, of course, wholly comparable to "corporation surtax net income, computed under section 15," the term which is critical in the present case; and, except for slight differences required by the separate sections of chapter 1 which define them, both terms originate in "net income" under Section 21(a), which is gross income under Section 22, less deductions under Section 23. The amount of a particular taxpayer's net income, of course, depends on what method of accounting is employed with respect to items entering into income. The point is that when a taxpayer elects to use the percentage-of-completion method under Section 736(b) for purposes of the excess profits tax, it has, for the purposes of that tax, elected to use that method in accounting for the positive items of income which enter into "net income," whether that net income subsequently becomes "normal tax net income" and ultimately "adjusted excess profits net income"

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[3] Section 710(b), *infra*, p. 20.

[4] Section 711(a), *infra*, p. 21.

—used in computing the tax under Section 710(a)(1)(A)—or whether that "net income" becomes "corporation surtax net income"—used in computing the tax under Section 710(a)(1)(B). Far from requiring the election to be limited to the former calculation, the statute definitely points the other way. There is no reason to insist that "corporation surtax net income" for Section 710(a)(1)(B) purposes must be computed under the completed-contract method, any more than that the computation of "normal tax net income" for chapter 1 purposes on the completed-contract method must govern the computation of "adjusted excess profits net income" under the first alternative excess-profits tax (Section 710(a)(1)(A)). The court below was therefore wrong in concluding that the amount of the taxpayer's corporation surtax net income for purposes of chapter 1 was its "actual" corporation surtax net income (R. 222). There can be no "actual" amount save by reference to the accounting method which is to be used—the percentage-of-completion method where the excess profits tax is involved, the completed-contract method for the ordinary income tax. At the least, the Commissioner cannot be deemed unreasonable for having taken this position.

In addition to the precise words of the statute, with which the Regulations are thus seen to be in harmony, the Commissioner reasonably understood that Congress did not intend that the alternative measures of the excess profits tax should depend

upon the vagaries that would ensue from using two, inconsistent, accounting methods for alternative computations of the same ultimate tax. It is clear that a taxpayer who has made the election will continue to use the completed-contract method in determining income for purposes of taxation under Chapter 1, while using the percentage-of-completion method for the excess profits tax computed under Section 710 (a) (1) (A). There is nothing, however, in the statute or its legislative history sanctioning the conclusion of the lower court that there is a dual concept of the same income which is subject to the alternative computations of the excess profits tax itself. The Commissioner's Regulations, in requiring that the same accounting method be used in computing the income that is subject to tax under both Section 710 (a) (1) (A) and Section 710 (a) (1) (B), thus avoid the possibility that definite items of income might never be subjected to the excess profits tax, or might be subjected to tax twice, as might be true under the decision below where, with reference, perhaps, to income from the very same long-term contract, a taxpayer could use the percentage-of-completion method of accounting in computing its tax under Section 710(a) (1) (A) in one year and the completed-contract method of accounting in computing its tax in a different taxable year under Section 710 (a) (1) (B). There is no indication that Congress ever intended that some income should completely escape the tax, or should

be taxed twice, by the device of using inconsistent accounting methods in successive years. Cf. *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 503.

3. The foregoing discussion makes plain, we think, that the decision of the Court of Appeals is in conflict with the uniform rulings of this Court that Treasury Regulations must be sustained by the courts unless unreasonable and plainly inconsistent with the statute which they interpret, and that the Regulations constitute contemporaneous constructions of the statute by its administrators which should not be overruled except for weighty reasons. *Commissioner* v. *South Texas Co.*, 333 U. S. 496; *Commissioner* v. *Wheeler*, 324 U. S. 542; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *Brewster* v. *Gage*, 280 U. S. 327; *Boske* v. *Comingore*, 177 U. S. 459. Moreover, there are special reasons for the application of that principle in this case. The Commissioner's Regulations deal with one of the most complex provisions of any revenue law, the excess profits tax; and Congress made doubly sure that this very aspect of the excess profits tax law would be covered by clarifying interpretations when it specifically provided that the election should be exercised in accordance with Regulations to be promulgated by the Commissioner. *Infra*, pp. 23-24. This Court has noted these two factors as added grounds why Regulations ought to be sustained unless it is perfectly plain that they are in

conflict with the statute. *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 503; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 102-103.

Even if the legislative language were more ambiguous, the court below should have refrained from nullifying the Regulations, much as it may have preferred a different interpretation itself, so long as the statute and its legislative history did not compel a different construction. Most certainly, it should not have declared that the Regulations were void as repugnant to the statute, when the repugnancy arose only after the court had rewritten the statute in its own fashion.

The burden of an abundance of tax litigation, vexatious to all, can only become more onerous when courts fail to accord due weight to the interpretations officially adopted by those who are charged with the administration of the statute. This is particularly true where, as here, the Regulations are capable of cutting both ways and, while favorable to the revenue in some circumstances, are favorable to taxpayers in other situations. Where a court, instead of inquiring whether the Regulations represent a permissible interpretation of the statute, insists on first drawing its own, independent conclusion concerning the meaning of the legislative language, and upholds the Regulations only if they express an interpretation of the statute which coincides with that which the court has already found to be preferable, an unwholesome situation is

likely to ensue. In such a climate of judicial approach, the Commissioner while applying the Regulations in some instances, would be impelled to deny their validity in every other situation where it would be advantageous to the fisc, thus forcing those taxpayers to resort to litigation to determine what interpretation will find favor with each particular appellate court. And, if a court is free to ignore the Regulations until after it has first selected a particular construction of the statute, opportunity for development of divergent views among the circuits and for the necessity of the intervention of this Court will normally be enhanced.

The present case is not an isolated holding that provisions of the Commissioner's Regulations under the excess profits tax are invalid. In *Commissioner* v. *John Breuner Co.*, No. 805, and in *Commissioner* v. *Busch's Kredit Jewelry Co., Inc.*, No. 804, petitions for writs of certiorari are being filed to review decisions of the Courts of Appeals for the Ninth and Second Circuits in which Regulations promulgated pursuant to Section 736 (a) of the Internal Revenue Code were declared invalid, as had already been the decision in *Kimbrell's Home Furnish., Inc.* v. *Commissioner,* 159 F. 2d 608 (C. A. 4). We believe it to be a matter of prime importance that this Court should again make it plain that its decisions with respect to the deference to be paid to the Commissioner's Regulations announce controlling principles.

4. The decision below raises a question of substantial importance in the administration of the revenue. As was indicated previously, while the interpretation adopted by the Commissioner in his Regulations results in a greater tax on this taxpayer than would be true under the decision of the court below, in the case of other taxpayers a larger tax would be owing if the Commissioner should be compelled to disregard his Regulations and should be required to follow the decision of the Court of Appeals.[5] Acting on the assumption that the Regulations express the proper view of the statute, and that taxpayers ought not to be compelled to resort to litigation to test their validity, the Bureau of Internal Revenue has already accepted returns in all other cases where taxpayers have followed the Regulations, notwithstanding that application of the Regulations has resulted in less tax in some cases, and has even made large refunds of taxes in other cases. Unless the decision in this case is reviewed by this Court, the Commissioner, to protect the revenue, will be required to determine deficiencies or to institute suits to recover refunds against these taxpayers, where such action has not become barred.

The question is also important to the revenue from the viewpoint of the total amount of tax in-

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[5] *I.e.*, the amount of corporation surtax net income (under Section 710(a)(1)(B)) may be greater if computed under the completed-contract method than under the percentage-of-completion method permitted by Section 736(b).

volved. The present case alone involves a difference of approximately $1,300,000 in tax, depending on whether the decision below is correct. In another case (*Sokol Brothers Furniture Co.* v. *Commissioner,* decided March 10, 1949 (1949 P-H T. C. Memorandum Decisions, par. 49,064)), the Tax Court followed its decision here; that case is now pending in the Court of Appeals for the Fifth Circuit. We are advised that there are some 12 other pending cases, involving Section 736 (b), which involve substantial amounts of revenue. We are also informed that there are 14 additional pending cases, involving Section 721 of the Code, with respect to which the application of the decision here will involve substantial amounts of revenue.

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

MAY, 1950.

APPENDIX

Internal Revenue Code:

SEC. 13 [As amended by Section 201 of the Revenue Act of 1939, c. 247, 53 Stat. 862.] TAX ON CORPORATIONS IN GENERAL.

(a) *Definitions.—For the purposes of this chapter—*

(1) *Adjusted Net Income.*—The term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

* * * * *

(2) [As amended by Section 105 (a)(1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Normal-Tax Net Income.*—The term "normal-tax net income" means the adjusted net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b).

* * * * *

[26 U. S. C. 1946 ed., Sec. 13]

SEC. 15 [As amended by Section 105 (b) of the Revenue Act of 1942, *supra*]. SURTAX ON CORPORATIONS.

(a) *Corporation Surtax Net Income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net in-

come minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced), and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26 (h). For the purposes of this subsection dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26 (b).

* * * * *

[26 U. S. C. 1946 ed., Sec. 15]

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

(b) [As amended by Section 210 (a) of the Revenue Act of 1939, *supra*] *Cross References.*—For definition of "adjusted net income" and "normal-tax net income", see section 13.

* * * * *

[26 U. S. C. 1946 ed., Sec. 21]

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following

credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(e) [As amended by Section 105 (d) of the Revenue Act of 1942, *supra*] *Income Subject to Excess-Profits Tax.*—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b)). In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 90 per centum. For the purpose of the preceding sentence the term "tax imposed by Subchapter E of Chapter 2" means the tax computed without regard to the limitation provided in section 710 (a)(1)(B) (the 80 per centum limitation), without regard to the credit provided in section 729 (c) and (d) for foreign taxes paid, and without regard to the adjustments provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727.

* * * * *

[26 U. S. C. 1946 ed., Sec. 26]

SEC. 710 [As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974.] IMPOSITION OF TAX.

(a) [As amended by Section 201(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 202 of the Revenue Act of 1942, *supra*] *Imposition.*—

(1) *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) 90 per centum of the adjusted excess-profits net income, or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter).

* * * * *

(b) *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

* * * * *

[26 U. S. C. 1946 ed., Sec. 710]

SEC. 711 [As added by Section 201, Second Revenue Act of 1940, *supra*]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a)(2), for such year except that the following adjustments shall be made:

* * * * *

[26 U. S. C. 1946 ed., Sec. 711]

SEC. 736 [As added by Section 222 (d) of the Revenue Act of 1942, *supra*]. RELIEF FOR INSTALLMENT BASIS TAXPAYERS AND TAXPAYERS WITH INCOME FROM LONG-TERM CONTRACTS.

(a) *Election to Accrue Income.*—In the case of any taxpayer computing income from installment sales under the method provided by section 44 (a), if such taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that the average volume of credit extended to purchasers on the installment plan in the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per centum of the volume of such credit extended to such purchasers in the taxable year, or the average outstanding installment accounts receivable at the end of each of the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per

centum of the amount of such accounts receivable at the end of the taxable year, or if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, in either case including only such years for which the income was computed under the method provided in section 44 (a), it may elect, in its return for the taxable year, for the purposes of the tax imposed by this subchapter, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, its income from installment sales on the basis of the taxable period for which such income is accrued, in lieu of the basis provided by section 44 (a). Except as hereinafter provided, such election shall be irrevocable when once made and shall apply also to all subsequent taxable years, and the income from installment sales for each taxable year before the first year with respect to which the election is made but beginning after December 31, 1939, shall be adjusted for the purposes of this subchapter to conform to such election. In making such adjustments, no amount shall be included in computing excess profits net income for any excess profits tax taxable year on account of installment sales made in taxable years beginning before January 1, 1940. If the taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that in a taxable year subsequent to the year with respect to which an election has been made under the preceding provisions of this subsection it

would not be eligible to elect such accrual method, the taxpayer may in accordance with such regulations elect in its return for such year to abandon such accrual method. Such election shall be irrevocable when once made and shall preclude any further elections under this subsection. For the taxable year for which the latter election is made and subsequent taxable years, income shall be computed in accordance with section 44 (c).

(b) *Election on Long-Term Contracts.*—In the case of any taxpayer computing income from contracts the performance of which requires more than 12 months, if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, it may elect, in its return for such taxable year for the purposes of this subchapter, or in the case of a taxable year the return for which was filed prior to the date of the enactment of the Revenue Act of 1942, within 6 months after the date of the enactment of such Act, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, such income upon the percentage of completion method of account-

ing. Such election shall be made in accordance with such regulations and shall be irrevocable when once made and shall apply to all other contracts, past, present, or future, the performance of which required or requires more than 12 months. The net income of the taxpayer for each year prior to that with respect to which the election is made shall be adjusted for the purposes of this subchapter, including the computation of excess profits net income in each taxable year of the base period under section 711 (b), to conform to such election but for purposes of chapter 1, the tax imposed by this subchapter for any prior taxable year on account of the adjustment required by this subsection shall be considered a part of the tax imposed by this subchapter for the taxable year in which such income is, without regard to this subsection, includible in gross income. Income described in this subsection shall not be considered abnormal income under section 721.

* * * * *

[26 U. S. C. 1946 ed., Sec. 736]

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.13-1. *Tax on Corporations in General.*—* * * The tax imposed by section 13 is computed upon the "normal-tax net income," that is, the adjusted net income minus the credit provided in section 26 (e) for income subject to the excess profits tax imposed by

subchapter E of chapter 2 and minus the credit for dividends received provided in section 26 (b), relating to dividends received from a domestic corporation which is subject to taxation under chapter 1 (85 percent of dividends received, but not in excess of 85 percent of the adjusted net income reduced by the credit provided in section 26 (e) for income subject to the excess profits tax imposed by subchapter E of chapter 2). The "adjusted net income" of a corporation is the net income as defined in section 21 minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and its instrumentalities.

* * * * *

SEC. 29.15-1. *Surtax on Corporations.*— * * *

The "corporation surtax net income" of a corporation is its net income minus (1) the credit provided in section 26 (e) for income subject to the excess-profits tax imposed by subchapter E of chapter 2, (2) the credit provided in section 26 (b) for dividends received, and (3) in the case of a public utility, the credit provided in section 26 (h) for dividends paid on its preferred stock. For the purposes of determining the corporation surtax net income, dividends received on the preferred stock of a public utility must be disregarded in computing the credit provided in section 26 (b) for dividends received. Also, for such purposes, such credit is limited to 85 percent of the corporation's net income (reduced by the credit

provided in section 26 (e) for income subject to the excess profits tax imposed by subchapter E of chapter 2), rather than to 85 percent of the adjusted net income so reduced. The credit provided in section 26 (a) for interest received on obligations of the United States or its instrumentalities is not allowable in computing corporation surtax net income.

* * * * *

SEC. 29.42-4. *Long-Term Contracts.*—Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used in this section the term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year from the date of execution of the contract to the date on which the contract is finally completed and accepted. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon either of the following bases:

(a) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract,

account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied.

(b) Gross income may be reported for the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion.

A taxpayer may change his method of accounting to accord with paragraph (a) or (b) of this section only after permission is secured from the Commissioner as provided in section 29.41-2.

Treasury Regulations 112, promulgated under the Internal Revenue Code:

SEC. 35.736(b)-2 *Election To Report Income Upon Percentage of Completion Basis.*—If the taxpayer satisfies the eligibility requirements provided in section 736 (b) and section 35.736 (b)-1 with respect to a taxable year beginning after December 31, 1939, it may elect in its excess profits tax return for such year, or if the election is made for a taxable year the excess profits tax return for which was filed prior to October 21, 1942 (the date of enactment of

the Revenue Act of 1942), it may elect not later than April 21, 1943 (six months after the date of enactment of the Revenue Act of 1942), to compute its income from long-term contracts upon the percentage of completion method of accounting under the provisions of section 29.42-4(a) of Regulations 111 or section 19.42-4(a) of Regulations 103 applicable to the taxable year for which the tax is being computed. An election made by the taxpayer pursuant to the provisions of section 30.736(b)(2) of Regulations 109 shall be deemed to be made pursuant to the provisions of this section.

* * * * *

SEC. 35.736(b)-3 [Amended by T. D. 5388, 1944 Cum. Bull. 387] *Computation of Net Income Upon Percentage of Completion Method of Accounting.*—(a) *Excess profits tax taxable year.*—If a taxpayer has elected under section 736 (b) and section 35.736(b)-2 to compute for excess profits tax purposes its net income from long-term contracts upon the percentage of completion method of accounting, in lieu of the completed contract basis, gross income from such long-term contracts shall be reported for each excess profits tax taxable year upon the basis of percentage of completion of such contract in such year. There shall be deducted from such gross income for a taxable year all expenditures made during such year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable

year for use in connection with the work under the contract but not yet so applied. Any deductions under section 23 which are limited to a percentage of net income (computed without regard to such deduction, as for example, the deduction for charitable contributions which is allowed by section 23 (q)) shall, for excess profits tax purposes, be determined upon the basis of such net income with the income from long-term contracts computed upon the percentage of completion method of accounting, and not upon the basis of net income for Chapter 1 purposes. No reserve for bad debts arising from accounts receivable from long-term contracts may be set up for excess profits tax purposes unless a reserve has been established for income tax purposes.

In computing the net operating loss deduction for the purposes of the excess profits tax for a taxable year pursuant to section 23 (s), section 122, and section 711 (a)(1)(J) or section 711 (a)(2)(L), the net operating loss under section 122 (a) and the net income under section 122 (b) for any taxable year prior or subsequent to the taxable year in which the election under section 736 (b) and section 35.736(b)-2 is made shall be determined by computing income from long-term contracts upon the percentage of completion method of accounting. The excess profits net income for the taxable year for which the net operating loss deduction is computed shall, for the purposes of the reduction provided by section 711 (a)(1) (J) (ii) or section 711 (a)(2)(L) (ii), be determined by computing income from

long-term contracts upon the percentage of completion method of accounting.

In computing normal tax net income for the purposes of determining excess profits net income, the credit for dividends received shall be limited to 85 percent of the adjusted net income computed by determining income from long-term contracts upon the percentage of completion method of accounting as provided in section 736 (b) and this section, instead of upon the completed contract basis.

The excess profits tax may be computed under section 710(a)(1)(B) as an amount which when added to the normal tax and surtax computed under Chapter 1 for the taxable year equals 80 percent of the corporation surtax net income properly adjusted under the provisions of section 710 (a)(1) (B) applicable to such year. For such purpose, the corporation surtax net income shall be determined by computing the income from long-term contracts upon the percentage of completion method of accounting. The credit for dividends received used in computing corporation surtax net income shall be limited to 85 percent of the net income determined by computing income from long-term contracts upon the percentage of completion method of accounting, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1.

* * * * *

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1949

No. 803

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

BASALT ROCK CO., INC.
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION.

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OPINIONS BELOW.

The opinion of the Tax Court (R. 148-170) and the dissenting opinions (R. 170-179) are reported at 10 T.C. 600. The opinion of the Court of Appeals (R. 219-224) is reported at 180 F.2d 281.

QUESTION PRESENTED TO THE COURT OF APPEALS.

The question before the Court of Appeals was whether the phrase "corporation surtax net income, computed under Section 15" in section 710(a)(1)(B) of the Internal

Revenue Code (part of the Excess Profits Tax Act) means the specific corporation surtax net income computed under section 15 of Chapter 1 of the Code, on which the surtax is imposed.

QUESTION PRESENTED TO THIS COURT.

The question before this Court is whether grounds appear, under the rules governing the Court's certiorari jurisdiction, for the granting of the writ.

Respondent prays that this Court deny the petition. It is respectfully submitted that among all of the grounds on which this Court exercises its discretion to grant the writ, there is not one which justifies its granting in this case. No conflict of decisions exists. The decision below is clearly correct. The case involves a narrow, nonrecurring question under the now repealed Excess Profits Tax Act which was applicable to an extremely limited group of taxpayers. So far as is known only one other case involving the point is pending in any Court. No principle of general or continuing importance in the administration of the revenue laws is involved.

STATEMENT OF THE CASE.

This case involves respondent's excess profits tax for the year 1942. One single issue of law was presented to the Court of Appeals. It concerned the construction of section 710(a)(1)(B) of the Internal Revenue Code, the

familiar 80 per cent limitation on total income and excess profits taxes, as applied to a limited group of taxpayers who, during the effective period of the excess profits tax law, made the special election permitted by section 736(b) of the Code to compute income from long-term contracts on the percentage-of-completion basis of accounting in arriving at "adjusted excess profits tax net income."

The excess profits tax was measured by section 710(a)(1)(A) or section 710(a)(1)(B), whichever resulted in the lesser tax.

Section 710(a)(1) provided:

"Sec. 710. IMPOSITION OF TAX.

(a) *Imposition.*—

(1) *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess profits net income, as defined in subsection (b), of every corporation * * * a tax equal to whichever of the following amounts is the lesser:

(A) 90 per centum of the *adjusted excess profits net income,* or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 * * * [i.e., the normal tax and surtax] equals *80 per centum of the corporation surtax net income, computed under section 15* * * *."

The last italicized phrase of the quoted section poses the legal question involved in this case. The facts giving rise to the question are stipulated, the findings of fact of the Tax Court being simply an adoption of these stipulated facts:

Respondent is a California corporation engaged in shipbuilding and the manufacture of concrete aggregates, road and fuel oils, and building material (R. 54). During the year 1942, and prior and subsequent thereto, part of its operations consisted of the performance of long-term contracts, that is, contracts requiring more than 12 months to perform. In 1942 respondent performed work on six such contracts, of which two were completed during the year and four were not completed until a later year (R. 55-56).

The method of accounting regularly employed by respondent with respect to long-term contracts was the completed contract method (R. 55). Under this method gross income from such contracts is included, and all expenditures allocable thereto are deducted, in the taxable year in which the contract is completed. This method clearly reflected respondent's net income and was consistently followed by it. Its long-term contract income for all corporate purposes was computed on this basis, and its federal income taxes (normal tax and surtax) for the year 1942 and for previous and subsequent years were computed, as they were required to be computed, on the same basis (R. 55).

By the Revenue Act of 1942 Congress amended the Excess Profits Tax Act by adding a provision intended to afford special relief to taxpayers engaged in the performance of long-term contracts. That amendment, section 736(b), provided in part:

> "In the case of any taxpayer computing income from contracts the performance of which requires more than 12 months * * * it may elect, in its return

for such taxable year for the purposes of this subchapter, * * * to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, such income upon the percentage of completion method of accounting."

Respondent made the election provided in the foregoing section. In its excess profits tax return for the taxable year 1942, therefore, it computed its income from long-term contracts on the percentage of completion method of accounting to arrive at its "adjusted excess profits net income." Both parties agree that taxpayer correctly thus computed its adjusted excess profits net income and therefore there is no dispute as to the amount of tax tentatively imposed by section 710(a)(1)(A).

By the terms of the statute, however, it was necessary to compute the tax tentatively imposed by section 710(a)(1)(B) since the tax actually imposed is the lesser of the two tentative taxes.

In computing this tax respondent turned, as section 710(a)(1)(B) directed, to its "corporation surtax net income, computed under section 15." The Commissioner contended, however, that while this income was the proper measure of respondent's surtax, it was not the measure of the 80 per cent limitation on the *combined* surtax, normal tax and excess profits tax. Instead, the Commissioner's regulation, *issued under section 736(b)*, purported to redefine the term used in section 710(a)(1)(B) by requiring respondent to use, in arriving at its *corporation surtax net income* when used as the measure of the 80 per cent limitation, the special percentage-of-completion

method of accounting that section 736(b) permitted respondent to use in arriving at its *adjusted excess profits net income* under Subchapter 2E (the Excess Profits Tax Act).

The Court of Appeals, agreeing with the views expressed in the forceful opinions of the five dissenting members of the Tax Court, rejected the Commissioner's contention. It held that the provisions of section 710(a)(1)(B) are clear and explicit; that the actual corporation surtax net income upon which the surtax is based and which is computed in accordance with the taxpayer's regular methods of accounting is the measure of the 80 per cent limitation; and that the Commissioner's regulation calling for the diametrically opposite result is inconsistent with the statute.

ARGUMENT.

The Government advances only two reasons for granting the writ in this case: (1) That the decision raises an important question concerning the deference to be accorded to the administrative interpretation of the revenue laws; and (2) that the decision below presents a question of importance to the revenue under the provisions of the Excess Profits Tax Act.

Neither of these reasons has substance. Before discussing them, however, we point out that the decision of the court below is clearly correct.

A. THE DECISION OF THE COURT OF APPEALS IS CORRECT.

In 1940, to provide the additional revenue required for the wartime economy, Congress enacted the Excess Profits Tax Act. This act was a separate chapter (Subchapter 2E) of the Internal Revenue Code. It imposed a tax on the special statutory "adjusted excess profits net income"—an income computed under numerous special provisions and designed, of course, to approximate the excess profits arising from the war economy.[1] This artificial income bore no necessary relation to the taxpayer's net income as defined in the income tax law. It might be, and in many cases was, zero, as when the excess profits tax credit exceeded the excess profits net income. In many cases, of course, it was substantial. This "adjusted excess profits net income" was subjected to a high rate of tax—90 per cent in the tax year in question; 95 per cent before the war was over. This excess profits tax was in addition to the ordinary income taxes imposed by Chapter 1 of the Internal Revenue Code. At all times these ordinary income taxes continued to be imposed upon the taxpayer's ordinary corporate income, i.e., the "normal tax net income" and the "surtax net income,"[2] both of which were computed—as from the beginning of the tax laws they have

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[1] *Commissioner v. South Texas Co.* (1948) 333 U.S. 496, 497.

[2] With a credit (not here involved)—the section 26(e) credit—which assured that the amount of the excess profits net income subject to tax at the 90 or 95 per cent rate would not again be subject to tax at the normal tax and surtax rates (section 26(e), I.R.C.).

been computed—under the taxpayer's regular accounting methods.[3]

In 1942, when Congress increased the excess profits tax rate on the "adjusted excess profits net income" to 90 per cent[4] it was concerned with the over-all effective rate of the *combined* normal tax, surtax and excess profits tax. Accordingly it enacted the 80 per cent limitation of section 710(a)(1)(B). Its purpose is clear from the legislative history.[5] It adopted as the limitation on

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[3]Section 15:

"(a) CORPORATION SURTAX NET INCOME.—For the purposes of this chapter, the term 'corporation surtax net income' means the net income minus [certain credits] * * *."

Section 41:

"The net income shall be computed upon the basis of the taxpayer's annual accounting period * * * *in accordance with the method of accounting regularly employed in keeping the books of such taxpayer;* * * *."*

[4]Revenue Act of 1942, c. 619, sec. 202, 56 Stat. 798, 899.

[5]Senate Report 1631, 1942-2 Internal Revenue Bulletins, pp. 504, 530, 636:

"Your committee feels that in no case should more than 80 per cent of *corporate profits* be taken in normal tax, surtax, and excess-profits tax. Consequently, the bill limits the over-all effective rate of these taxes to 80 per cent of the *surtax net income* before its reduction by the credit for the income subject to excess-profits tax. The effect of this provision is to reduce the excess-profits tax in such cases to an amount which when combined with the normal tax and surtax will not exceed the 80 per cent limitation."

* * * * * * *

"This section * * * amends section 710(a)(1) of the Code by inserting in lieu of the rate table now set forth therein a provision imposing the tax at a flat rate of 90 per cent of the adjusted excess profits net income. Your committee, however, believes that the sum of the corporate normal tax, surtax, and excess profits tax should not exceed 80 per cent of the corporation surtax net income (computed without any credit for income subject to excess profits tax). It has therefore amended this section to provide that the excess profits tax should be the lesser of the following: 90 per cent of

these *combined* taxes—*not* the artificial income arrived at under the excess profits tax chapter—but the "corporation surtax net income" computed under Chapter 1, that is, that income which represents the taxpayer's ordinary "corporate profits".[6] Clearly it never was intended, as the Commissioner's regulation purports to provide, that this measure should be altered by turning it into a hybrid income, computed in part under the concepts employed in arriving at the surtax net income and in part under those employed in arriving at the adjusted excess profits net income.

As pointed out by Judge Van Fossan in his dissenting opinion in the Tax Court (R. 171-172):

> "It is my judgment that petitioner is amply fortified in his contention that the term 'corporation surtax net income' denotes a specific concept which for any year can be only the precise amount arrived at under section 15 of Chapter 1, I.R.C., and that section 710(a)(1)(B) in no way suggests a new concept of corporation surtax net income. On the contrary, Congress, by the use of the term 'the corporation surtax net income' amplified by the phrase 'computed under section 15' and the reference to 'Chapter 1' indicated clearly that the 80 per cent limitation was to be based on the actual corporation surtax net income on which the corporation's surtax liability is imposed. In my judgment, section 710(a)(1)(B) was calculated to provide an alternative measure of the excess profits tax

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adjusted excess profits net income, or an amount which when added to the tax imposed by Chapter 1 (other than section 102) equals 80 per cent of the corporation surtax net income computed without the credit provided in section 26(c) for income subject to excess profits tax."

[6]See footnote 5.

independent of the measure of such tax under section 710(a)(1)(A).

* * * * *

And again by Judge Kern (R. 179):

> In my opinion section 710(a)(1)(B) in using the words and figures '* * * 80 per centum of the corporation surtax net income, computed under section 15 * * *' means exactly what it says and should not be construed to read '* * * 80 per centum of the corporation surtax net income, computed under section 15 and/or section 736(b) of subchapter E of Chapter 2 * * *'."

The Commissioner's theory—that the election exercised under section 736(b) must necessarily affect section 710(a)(1)(B) since it affects section 710(a)(1)(A)—is false logic. Actually, the election affects section 710(a)(1)(A) because it affects the other sections of the Excess Profits Tax Act, beginning with section 711, which in their entirety relate to the determination of "adjusted excess profits net income", the measure of the excess profits tax used in section 710(a)(1)(A). But the alternative measure of the excess profits tax used in section 710(a)(1)(B), "corporation surtax net income," *is not mentioned* elsewhere in the excess profits tax chapter. It is defined wholly in Chapter 1,[6a] and cannot be affected by an election which is operative only in the excess profits tax chapter.

[6a] Section 728, I.R.C., provided: "The terms used in this subchapter shall have the same meaning as when used in Chapter 1." Cf. *Brown Shoe Company, Inc. v. Commissioner*, No. 445, this Term, decided May 15, 1950.

The Commissioner ignores this manifest intent of Congress and suggests (Petn., p. 11) that his regulations are necessary to avoid possible "vagaries" that "might" ensue from using "two inconsistent accounting methods." The basic mistake in this reasoning is that the Commissioner treats sections 710(a)(1)(A) and 710(a)(1)(B) as though they were inconsistent when they are "alternative." "Consistency" in the tax law requires that the same accounting method shall be used in computing items of income and items of deduction in arriving at a measure of a tax.[7] Here the measure of tax used in section 710(a)(1)(A) is computed consistently from beginning to end under the specially elected method of accounting. The measure of tax used in section 710(a)(1)(B) is computed consistently from beginning to end under the taxpayer's regular method of accounting.

B. NO QUESTION OF IMPORTANCE AS TO THE EFFECT OF THE ADMINISTRATIVE INTERPRETATION OF THE REVENUE LAWS IS INVOLVED.

The Commissioner urges that the court below failed to follow the decisions of this Court with respect to the deference to be paid to his regulations. But there is no quarrel as to the governing principles. As the Commissioner himself says, the court properly held the regulation invalid if it was "plainly inconsistent with the statute" (Petn., p. 5). The sum of his complaint is rather that the court, "unaided by any language in section 736 (b) or the other excess profits tax provisions," held the regulation invalid (Petn., p. 8). Actually, it is the Commissioner's regulation that is "unaided by any language" in the statute.

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[7] *Commissioner v. South Texas Co.* (1948) 333 U.S. 496, 501.

The Commissioner tries to make it appear that there has developed in the lower courts a certain disregard for his regulations. He says: "The present case is not an isolated holding that provisions of the Commissioner's Regulations under the Excess Profits Tax are invalid" (p. 14). He calls attention to the cases of *Commissioner v. John Breuner Company* and *Commissioner v. Busch's Kredit Jewelry Co., Inc.*, in which another regulation was held invalid. He also mentions that that same regulation had previously been held invalid in *Kimbrell's Home Furnish., Inc. v. Commissioner of Int. Rev.*, 159 F.2d 608.

The fact that the courts of appeals of three circuits—and recently Judge Ford in the district court of the First Circuit[8]—all held that a part of the regulation under section 736(a) was invalid hardly indicates that there is among those courts an erroneous conception of the rule of law announced by this Court. On the contrary, the fact that so many of the lower courts have reached the same result on independent examination would seem adequate evidence that the Commissioner's regulation *is* invalid.

Since so many courts have agreed on the invalidity of the regulation involved in the *Breuner, Busch's Kredit* and *Kimbrell's Home Furnishings* cases, the imagined revolt against the Court's pronouncements on the weight to be given his regulations resolves into the one decision in this case. It is unnecessary, of course, to refer to the many regulations of the Commissioner which have been and are being held valid in the courts of all the circuits, nor is it necessary to point out that, of course,

[8] *Hadley Furniture Co. v. U. S.*, 87 F. Supp. 590.

with rare exceptions his regulations are sustained. In short, the Commissioner views with alarm a situation which does not exist. There is, in fact, no misunderstanding among the lower courts as to the effect of this Court's decisions on the weight to be accorded to the Commissioner's regulations. Thus, in the *Busch's Kredit Jewelry Co.* case itself, in the opinion of the court, Judge A. N. Hand said:

> "The words of Mr. Justice Black, * * * at page 501 * * * of his opinion in the South Texas case, to the effect that Treasury Regulations should not be overruled 'unless unreasonable and plainly inconsistent with the revenue statutes,' would not seem to sustain the regulation before us. While the statement enunciates a familiar rule, we think it has no application to the case at bar for the reason that Regulation 112, § 35.736(a)-2, if applied to the facts before us would fly in the face of the natural and reasonable meaning of Section 736(a) of the Code. We agree with the result reached by the Fourth Circuit in *Kimbrell's Home Furnishings, Inc. v. Commissioner, supra.*"[9]

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[9]In his petition for a writ of certiorari in the case of *Commissioner v. Rickenberg*, No. 491, this Term, the Commissioner also tried to give magnified significance to the fact that the lower court had held a part of a regulation invalid. In words very similar to those in his present petition, the Commissioner said:

> "In declaring Section 81.15 of Treasury Regulations 105 invalid as applied to the community property acquired after July 29, 1927, the Court of Appeals erroneously disregarded the principles established by numerous decisions of this Court that a Treasury regulation must be sustained unless it is plainly inconsistent with the statute and that, as a contemporaneous construction by the authority charged with administration of the statute, it is not to be overruled except for weighty reasons. See, e.g., *Commissioner v. South Texas Co.*, 333 U.S. 496, 501. The regulation here should have been sustained under these principles."

This Court, of course, denied that petition.

The Commissioner also asks that special weight be given to his regulation as a contemporaneous construction of the statute by its administrators. He fails to mention that from the time the question first arose his construction of section 710(a)(1)(B) was challenged by the Staff of the Joint Committee of Congress on Internal Revenue Taxation. For a considerable period that Committee withheld approval of refunds proposed by the Commissioner on the ground, expressed by its Chief of Staff who assisted in drafting the Revenue Act of 1942 and who testified before the committees of Congress in connection with the bill,[10] that the Commissioner's regulation was contrary to the statute (R. 134, 135).[11] In addition, the first time the question came before the Tax Court the point was decided in accordance with the conclusions of the Chief of Staff of the Joint Committee and with those now announced by the court below.[12] The Joint Committee final-

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[10]See hearings before Senate Finance Committee on H.R. 7378, Revenue Act of 1942, 77th Cong. 2nd Sess. Vol. 1, pp. 77 et seq.; hearings before the House Committee on Ways and Means on Revenue Revision of 1942, 77th Cong. 2nd Sess. Vol. 2, p. 1943.

[11]It is settled, of course, that where administrative construction has not been consistent and uniform, it "will be taken into account only to the extent it is supported by valid reasons."

Burnet v. Chicago Portrait Co. (1931) 285 U.S. 1, 16;
United States v. Mo. Pac. R. Co. (1929) 278 U.S. 269, 280;
Haggar Co. v. Helvering (1940) 308 U.S. 389, 398;
United States v. Factors & Finance Co. (1933) 288 U.S. 89, 95-96.

[12]*West End Furniture Co.*, 6 T.C. 557. The first opinion of the court in that case, printed at R.102-119, directed the computation of the 80 per cent limitation in accordance with the decision of the court below. The Commissioner filed a motion requesting the court to delete this portion of its opinion on the ground that the point was not before the court for decision (R. 121). The taxpayer having no objection, this motion was granted (R. 120). While in the circumstances the ruling is not authoritative, it illustrates the early challenge to the validity of the Commissioner's regulation. It is of particular interest to note the factual situation that arose in the

ly (in 1948) withdrew its objections. The fact remains that its contemporaneous construction was the same as the decision of the court below.

C. THERE IS NO CONFLICT OF DECISIONS AND THE PETITION PRESENTS NO QUESTION OF IMPORTANCE.

There is no conflict of decisions. The question involved is a narrow, highly technical point of statutory construction which applied to an extremely limited group of taxpayers. The provisions of the Excess Profits Tax Act which are here involved were enacted in 1942. They were in force until the end of 1945. During that entire period only 125 taxpayers made an election under section 736(b)[13], and of these an insignificant number were within the 80 per cent limitation. Five years have now elapsed since the law was repealed. In all of that time only two cases have arisen in the courts involving the point,[14] and on the Commissioner's own statements only twelve other taxpayers are possibly affected. Within this small group the regulation, as the Commissioner himself points out,

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West End Furniture case by virtue of the application of the Commissioner's rule—a situation which compelled the court's conclusion that the regulation simply could not square with the statute. In that case the "corporation surtax net income," when recomputed in accordance with the Commissioner's regulation to form the 80 per cent limitation, resulted in an anomalous figure *less* than the taxpayer's Chapter 1 taxes. Such a result never could have been contemplated by Congress, since section 710(a)(1)(B) in so many words provides that the alternative excess profits tax shall be in an amount which when "added" to the Chapter 1 taxes equals 80 per cent of the corporation surtax net income.

[13]According to figures supplied respondent by the Bureau of Internal Revenue.

[14]The case at bar and *Sokol Brothers Furniture Co. v. Commissioner*, referred to at page 16 of the Government's petition.

operates fortuitously, in some cases producing a greater tax, in others a lesser one, with no adverse over-all effect upon the revenue.[15] And certainly the Commissioner's position gains no added weight because he approved several refunds to taxpayers benefitted by his regulations at a time when the Tax Court had divided on their validity and the question was before the court below on the appeal of this respondent.

In the last sentence of the petition, without prior reference or any explanation, the Commissioner refers to the pendency of fourteen additional cases involving section 721. How the application of that section which involves the exclusion from excess profits net income of so-called "abnormal income" could be affected by the outcome of this case is nowhere disclosed.

Finally, there is an implication in the Government's petition that *Breuner, Busch's Kredit* and this case are related, and that in some manner the filing of petitions in the three cases simultaneously adds weight to the separate prayers for the writ in each. As the most casual inspection shows, the case at bar and the other two are wholly unrelated. In the court below the Government was

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[15]While, as the Commissioner says, the amount of tax involved in this particular case for the tax year in question is approximately $1,300,000, he concedes that if his regulations were applied to respondent in subsequent years less revenue might result in those years. The over-all effect of the Commissioner's regulation was emphasized by the Government in its opening statement in this case (R. 91-92):

> "I believe it important to emphasize, if your Honor please, that both of these rules here, both of these positions, can work out in favor of the government or in favor of the taxpayer. It is almost fortuitous as to one case or another whether it will result in a deficiency or a refund."

at pains to point out the lack of any similarity in the cases.[16]

CONCLUSION.

The decision below is correct. There is no conflict of decisions. No question of importance is presented. The petition should be denied.

Dated, San Francisco, California,
May 17, 1950.

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[16]In its brief in the *Breuner* case in the Court of Appeals the Government pointed out (pp. 25-26):

"The question involved in the *Kimbrell's* case and in this [the *Breuner*] case, it is readily apparent, is substantially different from that involved in the *Basalt Rock Co.* case. * * *

In the instant case * * * the question is *altogether different*, namely, whether the mere accrual of uncollected installment profits for excess profits tax purposes can cause them to be included in earnings and profits * * *."